No. 163

In the Supreme Court of the United States

October Term, 1945

Commissioner of Internal Revenue, petitioner

v.

Laird Wilcox and Maud Wilcox

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF RESPONDENTS

E. F. Lunsford
Bert M. Goldwater
George B. Thatcher
206 North Virginia Street
Reno, Nevada

William E. Davis
Washington, D. C.

Attorneys for Respondents.

CASE AUTHORITIES

Case Authorities (Continued)

STATUTES

TEXT AND OTHER AUTHORITIES

No. 163

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF RESPONDENTS

ARGUMENT

This case involves the construction of Section 22(a) of the Internal Revenue Code which reads:

"SEC. 22 GROSS INCOME.

(a) General Definition—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever, * * *"

In the case below, *Wilcox v. Commissioner*, 148 Fed. (2d) 933, the Circuit Court of Appeals for the Ninth Circuit held that embezzled funds did not constitute taxable gain or profit or income under Section 22(a) *supra*. The decision followed that of Circuit Court of Appeals for the Fifth Circuit in *McKnight v. Commissioner*, 127 Fed. (2d) 572. Both Circuit Courts reversed the Tax Court to reach the result.* In each case the Circuit Court had the benefit of the contra decision in *Kurrle v. Helvering*, 126 Fed. (2d) 723 (C. C. A. 8th) and rejected it.

Said the Circuit Court in *McKnight v. Commissioner*, (at page 574 of 127 Fed. (2d):

> "Our attention is called to the decision in Kurrle v. Helvering, 8th Cir. 126 Fed. ~~(2d)~~ 723, decided since this case was argued, where embezzled funds and the profits made by using them were taxed to the embezzler. We agree that the profits made by using embezzled funds are income and taxable as such, though possibly recoverable by the owner of the funds; *but we think no taxable gain arises by the embezzlement itself.*" (Italics supplied.)

Of the *Kurrle Case* the Court below said, (at page 935 of 148 Fed. (2d):

> "Respondent claims that the decision in the Eighth Circuit in Kurrle v. Helvering, 126 Fed. 2d 723, 725, is contra. That decision, however, relies upon the statement of law in the North American Consolidated Oil case, supra, concerning a taxpayer who "receives

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Wilcox v. Commissioner, Tax Court Memo. Dock. 3743, C. C. H. Dec. 14, 107, Aug. 21, 1944, reversed in *Wilcox v. Commissioner*, 148 Fed. (2d) 933; *Spruance v. Commissioner*, 43 B. T. A. 221, reversed sub. nom. *McKnight v. Commissioner*, 127 Fed. (2d) 572.

earnings under a claim of right" and appears to hold that, though received without claim of right, they are taxable if the embezzler subsequently "treated said funds as his own" in a profitable enterprise. If this be not a ground of distinguishing the Kurrle case from the instant review, we are not in accord with that opinion."

In construing Section 22(a) it is to be noted that income is defined as ". . . gains, profits and income derived from . . . dealings in property . . . growing out of the ownership or use of, or interest in such property; also . . . gains or profits and income derived from any source whatever." This means there must be a *gain*, or a *profit*, or an *income*. The Commissioner argues that the *use* of the money by the embezzler justifies the tax, but the tax is not upon the use in itself—it is upon the gain, income or profit *derived from the use* or *growing out of the use*. It is agreed by all courts, and the litigants here, that gains or profits arising out of or from dealings or investment of the embezzled money would be taxable as income. However, the question before the Court is solely whether the embezzeld monys are per se gains, profits or income.

The Commissioner argues that the embezzler having had the benefit of the embezzled funds, it should be regarded as the receipt of income by him. The respondent here who embezzled the money received no benefit as appears from the record showing loss of the money and subsequent imprisonment (R. 18). The dominion over and benefit of money may be equally argued, without success, as the basis for income tax upon gifts or loans.

The complete transfer to another of control over prop-

erty constitutes a gift and is taxable as such, but not as income. Mere benefit and enjoyment of property itself is the basis of a property tax.

Neither is borrowed money converted into income if the borrower spends the money for his own pleasure and exercises a dominion over it and obtains benefit from it. *William G. Stayton, Jr.*, 32 B. T. A. 940; *Carl G. Fisher*, 7 B. T. A. 968; *Shuster v. Helvering*, 121 Fed. (2d) 643.

Although "derived from any source whatever," be it out of a gift, a loan, or embezzled funds, income must be a gain or a profit. It cannot be the fund itself, but what the fund creates or produces.

The Circuit Court in the *McKnight case, supra*, treats the embezzler as a debtor, and states, (at page 573 of 127 Fed. (2d):

> "We find insuperable difficulties in the way of the conclusion that one who embezzles funds entrusted to him realizes gain and receives taxable income thereby. Gain is very broadly defined, as to its sources, in the Revenue Acts, Revenue Act 1934, Sect. 22; Revenue Act 1936, Sect. 22(a), 26 U. S. C. A. Int. Rev. Code. par. 22. The classic definition of income is: "'Gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets." Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 193, 64 L. Ed. 521, 9 A. L. R. 1570. It does not appear here what the embezzler did with what he took, whether he realized any profit from its use or conversion, or even got any enjoyment by spending it. All we know is it is gone and he is left insolvent. Was gain realized by the act of taking? We think not. He got no title, void or voidable, to what he took. He was still in possession as he was before, but with a

changed purpose. *He still had no right nor color of right. He claimed none. This the Board seems to concede*, and finds that the gain arose on his using the funds for his own purposes, whatever they were. The time of using, and not the time of taking, then would determine the incidence of the tax, and about that nothing is known. But when the entrusted fund is used, or even when taken with the purpose of dishonest use, the law immediately and absolutely fixes upon the embezzler the duty to account for and to repay the value of what is taken. No action or election by the owner is necessary. By the taking the embezzler incurs an equivalent debt as surely as if he had borrowed with the consent of the owner. The first takings are, indeed, nearly always with the intention of repaying, a sort of unauthorized borrowing. It must be conceded that no gain is realized by borrowing, because of the offsetting obligation. This would be true even though at the time there was no intention to repay. It seems to us that the same thing is true of each act of embezzlement. Commissioner v. Turney, 5 Cir., 82 F. 2d 661." (Italics supplied.)

We have stipulated with the Commissioner that the embezzled money is still due the rightful owner and that the owner always has and now does hold the taxpayer liable to restore the same. (R. 12-13.)

Thus, there is in the instant case an established creditor-debtor relationship between the embezzler and the rightful owner. There being an unqualified duty and obligation to repay, the embezzler has no taxable gain or profit. And under the principle involved, there can be no difference whether the money was legally borrowed or illegally taken. In both cases, the duty to repay immediately impresses itself upon the funds, offsetting any concept of gain or profit.

It is the law of Nevada, where the alleged embezzlement took place, that the offense is complete when the appropriation is made. *State v. Trolson*, 21 Nev. 419, 425, 427; 32 Pac. 930, 931; *Wilcox v. Commissioner*, 148 Fed. (2d) 933, 934. Also under Nevada law the owner could have replevined the moneys in possession of the embezzler, as soon as he appropriated them. Sec. 8681, *Nevada Compiled Laws, 1929*; *Perkins v. Barnes*, 3 Nev. 557; *Studebaker Co. v. Witcher*, 44 Nev. 468, 471; 199 Pac. 477, 201 Pac. 322. Nevada statutes further provide that embezzled property may be summarily restored to its owner by a magistrate. Sections 11243-11246, *Nevada Compiled Laws, 1929*. Hence, under local law the obligation of the embezzler set off and counter-balanced any conception of gain, profit or income. There could be no ownership or claim of right by the embezzler and even though, as stated by the Commissioner, "as against all the world except the true owner the embezzler or thief is the legal owner," it is not *ownership* or the appropriation of money which forms the basis of taxable income, but gains or profit *derived from ownership or use.*

Helvering v. Clifford, 309 U. S. 331; *Burnet v. Wells*, 289 U. S. 670, and *Helvering v. Horst*, 311 U. S. 112, cited by the Commissioner to illustrate the application of the doctrine that tax liability rests upon the enjoyment of privileges and benefits and the exercise of ownership are not in point here at all. In those cases there was an income derived and growing out of a fund, either trust or bonds; which gave a gain or profit to the respondent in each case. Actual income in *Helvering v. Clifford, supra*, of a short-

term trust created by a husband for his wife was taxed to the husband who controlled it. There was no question of the *existence* of income, but only to whom it was taxable. In *Burnet v. Wells, supra*, actual income of a trust when used to maintain insurance on the life of the settlor, was taxable to him as income. In *Helvering v. Horst, supra*, coupons reflecting income detached from the bonds by a donor thereof were taxable to him as income as a fruit of his investment which he obtained and disposed of as any other gift of income might be disposed.

The Commissioner relies on *Kurrle v. Helvering, supra.* An examination of that case will reveal that there was a *finding* that the embezzler "treated said funds as his own." (See page 724 of 126 Fed. (2d). Thus, the *Kurrle Case* is not controlling here and is distinguishable from the instant case and the *McKnight Case, supra*, on that ground. All the facts are not stated in *Kurrle v. Helvering, supra*, but from what is there said it is evident that the petitioner was a banker who used the moneys of depositors for his own personal market operations, treating the money as his own while on deposit. In such a situation it is clear that the money was taxable when so taken as the banker must have made claim of right to it while on deposit, merely giving depositors credit, but taking title to the funds. In the instant case at bar and in the *McKnight Case* no claim of right is found—there is an outright conversion completely lacking in any possessory right.

Although the case of *North American Oil v. Burnet*, 286 U. S. 417, did not involve embezzlement, the principle of that case laid down at page 424 of 286 U. S. has been

rightfully used to determine what is income. The Court there said:

> "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

The foregoing language has been relied on by numerous Circuit Courts, asking in each case whether the funds were received or appropriated with a claim of right, in order to arrive at the solution of whether funds are income to the receiver or appropriator. The rule of the *North American Oil Case* was applied in *Commissioner v. Turney*, 82 Fed. (2d) 661 (C. C. A. 5th), holding that mere possession and holding of money by an officer of a state without a well-founded claim of right does not constitute taxable income to such official. It is interesting to note that in *Kurrle v. Helvering*, 126 Fed. (2d) 723 (C. C. A. 8th), upon which the Commissioner relies, the Circuit Court of Appeals used the test of claim of right of the *North American Oil Case* in deciding the action. (See page 725 of 126 Fed. (2d).) Again the rule was applied in *Moore v. Thomas*, 131 Fed. (2d) 611 (C. C. A. 5th), the Court saying at page 613:

> "Here, insisting that his proof showed that the moneys taken by the taxpayer and reported as income were not in fact such but were the results of misappropriation or embezzlement of its subscribers' funds, appellant urges that our decision in McKnight v. Com'r, 5 Cir., 127 F. 2d 572, requires a reversal. Appellee, insisting that the record does not show this but on the contrary shows that all of the moneys

taken and reported as income were taken under a claim of right, urges that not McKnight v. Comm., but North American Oil Consolidated v. Burnett, 286 U. S. 417, 52 S. Ct. 613, 76 L. Ed. 1197, National City Bank of New York v. Helvering, 2 Cir., 98 F. 2d 93, Barker v. Magruder, 68 App. D. C. 211, 95 F. 2d 122, Chicago, R. I. & P. R. Co. v. Com'r, 7 Cir., 47 F. 2d 990, Board v. Com'r, 6 Cir., 51 F. 2d 73, control the decision here. We agree with appellee. Appelant's reliance on McKnight's case will not at all do. That, as the carefully written opinion points out, was a case of special circumstances. It was not intended to be, it was not, in conflict with the rule announced in North American Oil Co. v. Burnett and correctly applied in National City v. Helvering. *What was absent in McKnight's case, an appropriation under a claim of right, was present in those two cases and is present here.* The fact of which appellant seeks to make so much, that its officers, in asserting taxpayer's claim to the attorney-in-fact fees, acted with the corrupt motive of securing their distribution to themselves, is without bearing. The income of these officers and their title to the disbursed funds is not in question." (Italics supplied.)

In *Caldwell v. Commissioner*, 135 Fed. (2d) 488 (C. C. A. 5th), the yardstick of the *North American Oil Case* was applied. The Court said at page 491:

"These "kickbacks" do not at all appear to be plain embezzlements of the State's funds, but were paid by the contractors as their money, and *received by Caldwell as his own.* It may be that they were in some cases a fraud on the State for which it may recover, and Caldwell may be entitled in the year of such payment to a deduction, but until then they are his income. The situation is controlled by North American Oil Consolidated v. Burnet, 286 U. S. 417, 52 S. Ct. 613, 76 L. ed. 1197, rather than McKnight v. Commissioner, 5 Cir., 127 F. 2d 572." (Italics supplied.)

In *National City Bank of New York v. Helvering*, 98 F. (2d) 93, cited by the Commissioner, there was a *finding* by the Board of Tax Appeals (now the Tax Court) that the taxpayer "took all the bonds as his own" (page 95 of 98 Fed. (2d)). The Court then stated (at page 96):

> "If he [the taxpayer] holds with *claim of right*, he should be taxable as an owner, regardless of any infirmity of title." (Italics supplied.)

The remarks in that case regarding embezzled funds were unnecessary to the decision in the light of the findings that no embezzlement existed and should be disregarded as dicta.

Money taken through embezzlement is not taxable gain and is distinguished from all other illegal acquisition which arises from unlawful business transactions.

We concede that illegal profits and illegal gains are income. It is well settled that actual gains or profits may not be excluded from taxable income, merely because realized from activities or business condemned by penal statutes. As for instance:

Taxing the income of a bootlegger from the illegal sale of liquor.

United States v. Sullivan, 274 U. S. 259.

Including in income "commissions" received from road constructions company .

Chadick v. United States, 77 Fed. (2d) 961.

Gain from the purchase of sweepstakes tickets.

Christian H. Droge, 35 B. T. A. 829.

Race track bookmaking.

Jas. P. McKenna, 1 B. T. A. 326.

Card playing.

L. Weiner, 10 B. T. A. 905.

Unlawful insurance policies.

Patterson v. Anderson, 20 F. Supp. 799.

Illegal prize fight pictures.

George L. Rickard, 15 B. T. A. 316.

In these cases actual gain can be computed, and the money is not recoverable from the taxpayer by those who paid him.

We further concede that gains and profits received by a taxpayer and held by him under a claim of right not theretofore adversely adjudicated or denied by settled law, may be taxed to the recipient, although earned or received under *such circumstances that third persons could have demanded an accounting from the taxpayer for all or a part thereof.*

Such cases are well known:

Secret profits realized by a director of a corporation from dealings in the property of the corporation.

National City Bank of N. Y. v. Helvering, 98 Fed. (2d) 93.

Profits openly earned by an officer of a corporation but at the expense of the corporation.

Board v. Commissioner, 51 Fed. (2d) 73.

Usurious interest actually collected.

Barker v. Magruder, 95 Fed. (2d) 122.

Income of an attorney from the settlement of claims for less than the amount advanced to him for such purpose by his client.

United States v. Wampler, 5 Fed. Supp. 796.

Excessive commissions or bonuses to corporate officers.

Saunders v. Commissioner, 101 Fed. (2d) 407.

Excessive tariff charges.

Chicago, R. I. & P. Ry. v. Commissioner, 47 Fed. (2d) 990.

Dividends on stocks prematurely distributed.

Ford v. Commissioner, 51 Fed. (2d) 206.

It must be remembered that in all the last cited cases there was a *business transaction* and a holding under a *claim of right*. Further, no adjudication of the duty to return had been made or denied by settled law.

In *Humphreys v. Commissioner*, 125 Fed. (2d) 340 (C. C. A. 7th), Cert. den., 317 U. S. 637, cited by the Commissioner, there was an illegal business transaction with a claim of right to ransom money by a kidnapper, upon delivery of the body of the victim; and see also *Wilcox v. Commissioner*, 148 Fed. (2d) 933, 935. In *United States v. Wampler*, 5 Fed. Supp. 796, an attorney was taxable on income constituting money given to him to settle a case, part of which he retained after settling the matters for less than the amount delivered to him. The Court held that the act was not embezzlement (See page 798 of 5 Fed. Supp.). The money having been delivered in a business transaction for services there was a gain and profit.

The Commissioner argues that embezzled money should be taxable as income to the embezzler because the theft "creates a deductible loss from the beginning" to the

owner.* Such argument should no more succeed herein than in the case of a borrower who takes a loan and is not liable for the same as income, while the lender, unable to recover the loan, may deduct the non-payment as a loss. (See Treasury Regulations 103, Sec. 19.23(k)-1; 26 U. S. C. 23(k)(1)).

Comparison of the treatment of deductions for losses and thefts under the income tax law cannot determine what is income. Deductions, like exemptions, are privileges and will be allowed only when granted in clear language, the burden being on the taxpayer to show that he is within the statute granting the privilege of the deduction. *1 Mertens, Law of Federal Income Taxation*, 69, para. 3.08 (1942); *White v. U. S.*, 305 U. S. 281, 292.

On the other hand, taxable income must come within the import of Section 22(a), *supra*, of the Internal Revenue Code, and if doubt exists as to whether embezzled funds are taxable income, such doubt should be construed most strongly against the government and in favor of the taxpayer. *Gould v. Gould*, 245 U. S. 151, 153. It is for the government to find a gain or profit from embezzled funds within Section 22(a), *supra*. Only the *Kurrle Case, supra*,

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*The reasoning in *Boston Consolidated Gas Co. v. Commissioner*, 128 Fed. (2d) 473 (C. C. A. 1st) sustains the position of respondents here that the owner from whom the money is embezzled does not sustain a loss at the time of the taking because of the offsetting obligation of the embezzler to repay. (See Concurring Opinion of Judge Magruder at page 477 of 128 Fed. (2d)); See also *Glenn v. Louisville Trust Co.*, 124 Fed. (2d) 418, 420.

so held and that by giving the omnibus clause of the section a strained construction. True, income is ". . . gains or profits and income derived from any source whatever . . .", but the requirement of gain or profit is still present.

CONCLUSION

A careful reading of Section 22(a) of the Internal Revenue Code will reveal that embezzled funds do not fall within its terms as taxable income. The exercise of use or ownership over funds does not convert such funds into taxable gain, profit or income unless there is created or produced from such fund an actual gain or profit. The complete lack of a claim of right to the funds, conceded by the Commissioner, emphasizes the rule of numerous cases that the funds can not constitute income. Furthermore, the unqualified obligation of the embezzler to restore the funds to the owner, as stipulated by the Commissioner and respondents, completely counter-balances any concept of gain, profit or income.

It is respectfully submitted that the judgment of the Ninth Circuit Court of Appeals should be affirmed.

E. F. Lunsford
Bert M. Goldwater
206 North Virginia Street
Reno, Nevada
Counsel for Respondents.

George B. Thatcher
206 North Virginia Street
Reno, Nevada
William E. Davis
Washington, D. C.
Of Counsel for Respondents.

Reno, Nevada, December, 1945.

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SUPREME COURT OF THE UNITED STATES.

No. 163.—October Term, 1945.

Commissioner of Internal Revenue, Petitioner, *vs.* Laird Wilcox and Maud Wilcox.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[February 25, 1946.]

Mr. Justice Murphy delivered the opinion of the Court.

The sole issue here is whether embezzled money constitutes taxable income to the embezzler under Section 22(a) of the Internal Revenue Code.[1]

The facts are stipulated. The taxpayer was employed as a bookkeeper by a transfer and warehouse company in Reno, Nevada, from 1937 to 1942. He was paid his salary promptly each month when due, it not being the custom to allow him to draw his salary in advance. In June, 1942, the company's books were audited and it was discovered for the first time that the taxpayer had converted $12,748.60 to his own use during 1941.[2] This amount was composed of miscellaneous sums of money belonging to the company which he had received and collected at various times in his capacity as bookkeeper. He failed to deposit this money to the credit of the company. Instead he pocketed and withdrew payments in cash made to him by customers, neglecting to credit the customers' accounts or the company's accounts receivable with the funds received.

The taxpayer lost practically all of this money in various gambling houses in Reno. The company never condoned or forgave the taking of the money and still holds him liable to restore it. The taxpayer was convicted in a Nevada state court in 1942 of the crime of embezzlement. He was sentenced to serve from 2 to 14 years in prison and was paroled in December, 1943.

The Commissioner determined that the taxpayer was required to report the $12,748.60 embezzled in 1941 as income received in

[1] 26 U. S. C. § 22(a).

[2] The sum of $10,147.41 was embezzled during 1942 but that amount is not in issue in this case.

that year and asserted a tax deficiency of $2,978.09. The Tax Court sustained the Commissioner but the court below reversed. 148 F. 2d 933. We granted certiorari because of a conflict among circuits as to the taxability of embezzled money.[3]

Section 22(a) of the Internal Revenue Code defines "gross income" to include "gains, profits and income derived from . . . dealings in property . . . growing out of the ownership or use of or interest in such property; also . . . from the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever." The question thus is whether the wrongful acquisition of funds by an embezzler should be included in the statutory phrase "gains or profits and income derived from any source whatever," thereby constituting taxable income to the embezzler.

The Commissioner relies upon the established principle that orthodox concepts of ownership fail to reflect the outer boundaries of taxation. As this Court has stated, tax liability "may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." *Burnet* v. *Wells*, 289 U. S. 670, 678. See *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Horst*, 311 U. S. 112. Applying that rule to this case, the Commissioner urges that the act of appropriating the property of another to one's own use is an exercise of a major power of ownership even though the act is consciously and entirely wrongful. As against all the world except the true owner the embezzler is the legal owner, at least while he remains in possession. The money or property acquired in this unlawful manner, it is said, should therefore be treated as taxable income to the wrongdoer under Section 22(a). We cannot agree.

Section 22(a) is cast in broad, sweeping terms. It "indicates the purpose of Congress to use the full measure of its taxing power within those definable categories." *Helvering* v. *Clifford*, *supra*, 334. The very essence of taxable income, as that concept is used in Section 22(a), is the accrual of some gain, profit or benefit to the taxpayer. This requirement of gain, of course, must be read in its statutory context. Not every benefit received by a

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[3] The decision below is in accord with McKnight *v.* Commissioner, 127 F. 2d 572 (C. C. A. 5), but is in conflict with Kurrle *v.* Helvering, 126 F. 2d 723 (C. C. A. 8). See also Boston Consol. Gas Co. *v.* Commissioner, 128 F. 2d 473, 476-477 (C. C. A. 1, concurring opinion).

taxpayer from his labor or investment necessarily renders him taxable. Nor is mere dominion over money or property decisive in all cases. In fact, no single, conclusive criterion has yet been found to determine in all situations what is a sufficient gain to support the imposition of an income tax. No more can be said in general than that all relevant facts and circumstances must be considered. See Magill, Taxable Income (1945).

For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of Section 22(a). See *North American Oil v. Burnet*, 286 U. S. 417, 424. Nor can taxable income accrue from the mere receipt of property or money which one is obliged to return or repay to the rightful owner, as in the case of a loan or credit. Taxable income may arise, to be sure, from the use or in connection with the use of such property. Thus if the taxpayer uses the property himself so as to secure a gain or profit therefrom, he may be taxable to that extent. And if the unconditional indebtedness is cancelled or retired taxable income may adhere, under certain circumstances, to the taxpayer. But apart from such factors the bare receipt of property or money wholly belonging to another lacks the essential characteristics of a gain or profit within the meaning of Section 22(a).

We fail to perceive any reason for applying different principles to a situation where one embezzles or steals money from another. Moral turpitude is not a touchstone of taxability. The question, rather, is whether the taxpayer in fact received a statutory gain, profit or benefit. That the taxpayer's motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of Section 22(a).

It is obvious that the taxpayer in this instance, in embezzling the $12,748.60, received the money without any semblance of a bona fide claim of right. And he was at all times under an unqualified duty and obligation to repay the money to his employer. Under Nevada law the crime of embezzlement was complete whenever an appropriation was made;[4] the employer was entitled to

[4] State v. Trolson, 21 Nev. 419, 32 P. 930.

replevy the money as soon as it was appropriated[5] or to have it summarily restored by a magistrate.[6] The employer, moreover, at all times held the taxpayer liable to return the full amount. The debtor-creditor relationship was definite and unconditional. All right, title and interest in the money rested with the employer. The taxpayer thus received no taxable income from the embezzlement.

This conclusion is unaltered by the fact that the taxpayer subsequently dissipated all of the embezzled funds in gambling houses. The loss or dissipation of money cannot create taxable income here any more than the insolvency or bankruptcy of an ordinary borrower causes the loans to be treated as taxable income to the borrower. See *McKnight* v. *Commissioner*, 127 F. 2d 572, 573-574. In each instance the taxability is determined from the circumstances surrounding the receipt and holding of the money rather than by the disastrous use to which it is put. Likewise, the fact that a theft or loan may give rise to a deductible loss to the owner of the money does not create income to the embezzler or the borrower. Such deductions, lacking any necessarily corresponding relationship to gains and being a matter of legislative grace, fail to demonstrate the existence of taxable income.

Had the taxpayer used the embezzled money and obtained profits therefrom such profits might have been taxable regardless of the illegality involved.[7] Or had his employer condoned or forgiven any part of the unlawful appropriation the taxpayer might have been subject to tax liability to that extent. But neither situation is present in this proceeding and we need not explore such possibilities. Sanctioning a tax under the circumstances before us would serve only to give the United States an unjustified preference as to part of the money which rightfully and completely belongs to the taxpayer's employer.

The Tax Court's determination that the embezzled money constituted taxable income to the embezzler, a result in accord with

[5] Nevada Compiled Laws (1929) § 8681; Perkins *v.* Barnes, 3 Nev. 557; Studebaker Co. *v.* Witcher, 44 Nev. 468, 199 P. 477.

[6] Nevada Compiled Laws (1929) §§ 11243-11246.

[7] See Johnson *v.* United States, 318 U. S. 189; United States *v.* Sullivan, 274 U. S. 259; Caldwell *v.* Commissioner, 135 F. 2d 488; Chadick *v.* United States, 77 F. 2d 961; National City Bank *v.* Helvering, 98 F. 2d 93. See also Mann *v.* Nash [1932] 1 K. B. 752; Southern *v.* A. B. [1933] 1 K. B. 713.

its prior decisions on the issue,[8] involved a clear-cut mistake of law. The court below was therefore justified in reversing that judgment. Cf. ***Commissioner* v. *Scottish American Co.*, 323 U. S. 119; *Dobson* v. *Commissioner*, 320 U. S. 489; *Trust of Bingham* v. *Commissioner*, 325 U. S. 365.**

Affirmed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

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[8] See Spruance *v.* Commissioner, 43 B. T. A. 221, reversed *sub nom.* McKnight *v.* Commissioner, 127 F. 2d 572; Kurrle *v.* Commissioner, Prentice-Hall 1941 B. T. A. Memorandum Decisions, par. 41,085, affirmed 126 F. 2d 723. The administrative interpretation is to the same effect as the Tax Court's decisions. G. C. M 16572, XV-1 Cum. Bull. 82 (1936).

SUPREME COURT OF THE UNITED STATES.

No. 163.—October Term, 1945.

Commissioner of Internal Revenue, Petitioner, *vs.* Laird Wilcox and Maud Wilcox.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[February 25, 1946.]

Mr. Justice Burton, dissenting.

By holding in this case that embezzled funds do not constitute a taxable gain to the embezzler under the Internal Revenue Code, I believe the Court misinterprets the Code. That interpretation is contrary to the established administrative construction of the Code and to what appears to be the intent of § 22(a) as disclosed by its legislative history. Section 22(a) expressly includes in "the net income of a taxable person . . . gains or profits and income derived from any source whatever." 26 U. S. C., § 22(a). It is difficult to imagine a broader definition. This Court has said of this section, "The broad sweep of this language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories." *Helvering* v. *Clifford*, 309 U. S. 331, 334.

The legislative history of the section demonstrates the Congressional intent to tax not merely "lawful" gains but all gains lawful or unlawful. Section II B of the Income Tax Act of 1913, 38 167, provided originally that—

> ". . . the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any *lawful* business carried on for gain or profit, *or gains or profits and income derived from any source whatever*, ..." (Italics supplied.)

The Revenue Act of 1916 (39 Stat. 757), § 2(a), reenacted this provision omitting only the word "lawful" before the word "business" so that now the final clause, as incorporated in § 22(a), reads, "also from interest, rent, dividends, securities, or the transaction of *any business* carried on for ~~gain~~ or profit, *or gains or profits and income derived from any source whatever.*" (Italics supplied.) The 1916 amendment demonstrated an intent to include gains, profits and income from any unlawful business as well as from any lawful business. It is inescapable evidence of a like intent to include unlawful as well as lawful "gains . . . from any source whatever." See *United States* v. *Sullivan*, 274 U. S. 259.

There have been many decisions to the effect that this section includes such unlawful gains as those from illicit traffic in liquor,[1] race-track bookmaking,[2] card playing,[3] unlawful insurance policies,[4] illegal prize fighting pictures,[5] lotteries,[6] graft,[7] fraudulent misapplied moneys of a client by an attorney,[8] "protection payments" to racketeers and ransom money paid to a kidnapper.[9]

The majority opinion in the present case recognizes that had "the taxpayer used the embezzled money and obtained profits therefrom such profits might have been taxable regardless of the illegality involved." The majority opinion therefore does not exempt the embezzled funds from taxation merely because there is "illegality involved". The opinion reaches its result by reading into § 22(a) a legislative distinction I do not find there. The opinion limits the section to such gains, unlawful or not, as are accompanied with "a claim of right" by the taxpayer and as are not accompanied with "a definite unconditional obligation to repay or return that which would otherwise constitute a gain."

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[1] United States *v.* Sullivan, 274 U. S. 259. See also, Steinberg *v.* United States, 14 F. 2d 564; Maddas *v.* Commissioner, 40 B. T. A. 572, affirmed, 114 F. 2d 548; Poznak *v.* Commissioner, 14 B. T. A. 727.

[2] M'Kenna *v.* Commissioner, 1 B. T. A. 326.

[3] Weiner *v.* Commissioner, 16 B. T. A. 905.

[4] Patterson *v.* Anderson, 20 F. Supp. 799.

[5] Rickard *v.* Commissioner, 15 B. T. A. 316.

[6] Droge *v.* Commissioner, 35 B. T. A. 829; Huntington *v.* Commissioner, 35 B. T. A. 835; Voyer *v.* Commissioner, 4 B. T. A. 1192.

[7] Chadick *v.* United States, 77 F. 2d 961, cert. denied, 296 U. S. 609.

[8] United States *v.* Wampler, 5 F. Supp. 796.

[9] Humphreys *v.* Commissioner, 42 B. T. A. 857, affirmed, 125 F. 2d 340.

Believing, as I do, that Congress in this section has sought "to use the full measure of its taxing power," and in doing so has sought to tax all "gains . . . from any source whatever," I am unable to recognize an adequate basis for reading into the broad sweep of the language the unexpressed limitation proposed in the majority opinion.

The embezzler's complete possession of the embezzled funds, his exercise of dominion over them to the extent of disposing of every cent of them and his transfer of possession of them to others in such a manner as to give the recipients title to them, amounts to such an ample enjoyment of them, use of them, dominion over them, disposition of them and receipt of benefits from them as to make them of obvious economic value to the embezzler. Such a readily realizable value presents no reasonable basis for exempting these funds from taxation that would be applied to them if earned in a lawful manner. The "Government . . . may tax not only ownership, but any right or privilege that is a constituent of ownership. . . . Liability may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." *Burnet* v. *Wells*, 289 U. S. 670, 678.

In *National City Bank of New York* v. *Helvering*, 98 F. 2d 93, 96, L. Hand, J., writing for the court, said:

> "Although taxes are public duties attached to the ownership of property, the state should be able to exact their performance without being compelled to take sides in private controversies. Possession is in general prima facie evidence of ownership, and is perhaps indeed the source of the concept itself, though the time is long past when it was synonymous with it. It would be intolerable that the tax must be assessed against both the putative tortfeasor and the claimant; collection of the revenue cannot be delayed, nor should the Treasury be compelled to decide when a possessor's claims are without legal warrant."

In the present case, the embezzler concealed the embezzlement long enough to enable him to gamble away all of the embezzled funds. He asserted, falsely to be sure, but nonetheless positively, his right to dispose of the funds and he did dispose of them beyond all chance of their recovery. This was a use of them by him for his own enjoyment just as fully as though he had legal title to them. If he had made gambling or other profits from them he

would have claimed those profits as his own and would have been taxed on those profits. If he had gained possession of the original funds by extortion, fraud or usurious practices, those gains would be taxable to him under the general language of § 22 (a). The majority opinion, however, holds that if he gained possession of the original funds by embezzlement then such gains are not to be taxed to him under that language. This reads into the section a sharp distinction between the embezzler and defrauder, exempting the former but not the latter. In the absence of an express declaration of such an intent by Congress I believe that the courts are not justified in reading such a distinction into this section.

Furthermore, where an embezzler uses embezzled funds for his own purposes and, by concealment of the embezzlement or otherwise, deprives his victim of a corresponding opportunity to enjoy those funds, the Code permits this victim to deduct as a "loss", from the victim's taxable income, the sums so embezzled.[10] See *Burnet* v. *Huff*, 288 U. S. 156. The allowance of such a deduction suggests the intent of Congress to transfer the liability for the tax on those funds to the embezzler. The majority opinion prevents such a transfer.

A point has been made of the fact that the Government's tax lien upon property of the embezzler would have priority over the claim of the victim of the embezzlement to recover from such property the losses which the victim suffered by the embezzlement. This priority of the tax lien is hardly an adequate argument to eliminate the tax itself. At most it is an argument for Congress to modify the tax lien in favor of the victim.

There is nothing in the Code that expressly requires, as a condition of the existence of a taxable gain, that there also be an absence of "a definite unconditional obligation to repay or return that which would otherwise constitute a gain." In the case of *National City Bank of New York* v. *Helvering*, *supra*, p. 95, the taxpayer was taxed on bonds which he had unlawfully withheld from the corporation of which he was an officer. These bonds were the property of the corporation in the sense that it could have reclaimed them and the court said—

> "But there are several cases in which persons have been taxed upon property which could be recovered from them. For example, the lender upon usurious interest—if on an accrual

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[10] 26 U. S. C. § 23(e).

basis' must include his apparent profit in his return, though possibly he may be allowed to deduct it as a loss if the borrower reclaims it. *Barker v. Magruder*, 68 App. D. C. 211, 95 F. 2d 122. Again, when a railroad collects too large fares, the excess is income, though the passengers have a theoretical right of restitution. *Chicago R. I. & P. R. Co. v. Commissioner*, 7 Cir., 47 F. 2d 990."

The administrative interpretation of § 22 (a) long has been to tax the embezzled funds. It dates at least from G. C. M. 16572, XV-1 Cum. Bull. (1936) 82, in which it was expressly recommended that the "profits of an embezzler constitute taxable income in the hands of the embezzler for federal income tax purposes." This interpretation was followed by the Tax Court in this case and it has been regularly followed by the Board of Tax Appeals in the past. *Kurrle v. Commissioner*, 1941 Prentice-Hall B. T. A. Mem. Decisions, ¶ 41,085, affirmed, 126 F. 2d 723; *Estate of Spruance v. Commissioner*, 13 B. T. A. 221, reversed *sub nom. McKnight v. Commissioner*, 127 F. 2d 572.

Because of the legislative history of § 22 (a), the breadth of the language used by Congress in that section, the attempt of Congress to use the full measure of its taxing power in that section, the long established administrative practice of holding embezzled funds to be taxable income of the embezzler, and finally because of the arbitrary distinctions in favor of the embezzler which arise from an opposite interpretation of the Code, I believe that embezzled funds are taxable gains as defined by Congress.